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Supreme Court, U.S.
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No. .....

In the

Supreme Court of the United States

ALLEN M. EARLY and JEANNETTE B. EARLY
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Writ of Certiorari to review the Decision of the United States Court of Appeals for the Fifth Circuit

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REPORTS OF COURTS BELOW

This Court is respectfully requested to review the decision of the United States Court of Appeals for the Fifth Circuit, Docket No. 29240, decided on May 21, 1971. This decision reverses the decision of the United States Tax Court issued on June 26, 1969, 52 T.C. 560. Copies of both opinions are appended hereto.

GROUNDS ON WHICH JURISDICTION IS INVOKED

The judgment of the Court of Appeals for the Fifth Circuit sought to be reviewed was entered on May 21, 1971. A petition for rehearing was filed on June 1, 1971. This petition was denied on June 16, 1971 without opinion. The statutory provision confering on this Court jurisdiction to review the judgment of the Court of Appeals for the Fifth Circuit in cases originating in the United States Tax Court is Section 7482(a) of the Internal Revenue Code of 1954 (26 U.S.C. Sec. 7482(a)).

QUESTION PRESENTED FOR REVIEW

The question presented for review is whether the Court of Appeals for the Fifth Circuit erred in reversing the United States Tax Court and holding that, when Allen Early exchanged 70,000 shares of El Paso Natural Gas Company stock, which he had previously acquired from Rose Van Wert by gift a year before her death, for a life interest in the income from her estate, he did not make a taxable exchange but merely perfected his gift. Hence it was held that the life interest was acquired by gift and not by purchase, and therefore its basis was not returnable through depreciation allowances.

STATUTES INVOLVED

The following sections of the Internal Revenue Code of 1954 (26 U.S.C.) are involved in this case;

Section 167(a) General rule. There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance

for obsolescence) (1) of property used in the trade or business, or (2) of property held for the production of income.

Section 273. Holders of life or terminable interest. Amounts paid under the laws of a State, a Territory, the District of Columbia, a possession of the United States, or a foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time.

Section 1014(a) In general. Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or, in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections.

Section 1014(b). Property acquired from a Decedent. For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

* * * * *

(9) In the case of decedents dying after December 31, 1953, property acquired from the decedent by reason

of death, form of ownership, or other conditions (including property acquired through the exercise or non-exercise of a power of appointment), if by reason thereof the property is required to be included in determining the value of the decedent's gross estate under chapter 11 of subtitle B or under the Internal Revenue Code of 1939. In such case, if the property is acquired before the death of the decedent, the basis shall be the amount determined under subsection (a) reduced by the amount allowed to the taxpayer as deductions in computing taxable income under this subtitle or prior income tax laws for exhaustion, wear and tear, obsolescence, amortization, and depletion on such property before the death of the decedent. Such basis shall be applicable to the property commencing on the death of the decedent.

Section 2036(a) General rule. The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property.

STATEMENT OF THE CASE

The taxpayers, Allen and Jeanette Early, are husband and wife and reside in Dallas, Texas. They filed joint income

tax returns for the years 1964 and 1965 with the District Director at Dallas, Texas. Both of them were friends of Sam and Rose Van Wert. For several years prior to 1954 Allen acted as Sam Van Wert's accountant. Following Sam's death in that year, Allen performed the same services for Rose until her death. At her husband's death she was left with real and personal property of substantial value, including 70,000 shares of stock in El Paso Natural Gas Company. The certificates and instruments evidencing her ownership, together with her books and records, were kept in Allen's possession at all times.

In November 1957 Rose executed stock powers, covering the certificates representing the 70,000 shares of El Paso Natural Gas Company stock in Allen's possession, to Allen and his wife. Her signature on the powers was guaranteed by an officer of a bank. When she gave Allen the powers she told him she was making him a gift of the stock, but she asked him not to transfer the stock to his name until after her death, so she could continue to receive the income from the stock during her lifetime.

Rose died on August 12, 1958. She left a will and a codicil in which she appointed Allen and another as co-executors, made certain specific bequests, and directed that the residue of her estate should be placed in trust with the income to be paid to her physician and his wife for their lives, the remainder to certain charities. The will and codicil did not mention the 70,000 shares of El Paso stock. Allen and his wife claimed ownership of the stock as an intervivos gift from Rose.

Rose's will and codicil were contested by her intestate heirs on the grounds of undue influence and lack of testimentary capacity, and certain of the beneficiaries objected to Allen retaining the El Paso stock, claiming that he had not acquired it by gift, but only held the stock powers as Rose's agent so he could properly administer her affairs, threatening suit to recover the stock.

A settlement was reached in November 1959 whereby Allen agreed to deliver the stock to the estate, destroy the stock powers, and receive in lieu of such stock a life interest for him and his wife in 32 percent of the income from the trust, reduced by $4,000 per year for four years. In connection with this settlement Allen incurred legal fees of $20,000.

The El Paso stock released to the estate had a fair market value at the date of transfer of $2,288,125, and it was included in Rose's estate for federal estate tax purposes at that value as a transfer by gift with a life interest therein retained by the donor. The El Paso stock comprised 53 percent of the corpus of the estate delivered to the testamentary trustee. The value of Allen's life estate in the trust income was $716,919.91, based upon an expectancy for him and his wife of 31.16 years, based on the Commissioner's tables.

On January 12, 1960, Allen, acting as co-executor of the estate, filed a gift tax return for 1957 reporting the market value of the El Paso stock at the date of the 1957 transfer as a taxable gift and paying a gift tax thereon. In October 1961 the estate filed a protective refund claim for this gift

tax. Allen, acting as co-executor of the estate, and the estate tax examiner, negotiated a compromise of the claim in which it was agreed that Rose would be considered to have made a completed gift in 1957, measured by the value of the life estate ultimately received by Allen and his wife. By this settlement the gift tax was reduced to $161,181.29, and the estate was given a credit against the Federal estate taxes of this amount for gift taxes paid.

During the years 1961 to 1965 inclusive, Allen and his wife reported as income the payments they received from Rose's trust. They took deductions for depreciation based upon the cost basis of their life estate, computed by adding to the value of such life estate when acquired the $20,000 legal fees paid, and dividing this amount by their life expectancy of 31.16 years. But since the trust received part of its income in the form of tax exempt interest, Allen allocated part of the depreciation to taxable income and part to non-taxable income, and did not claim a deduction for the part allocated to non-taxable income.

In the current years, 1964 and 1965, the Commissioner disallowed the depreciation deductions on the grounds that the life interest was acquired by gift and hence the deductions were prohibited by Section 273 of the Internal Revenue Code. Allen and his wife filed a petition to the United States Tax Court, asserting that Section 273 did not apply, and also that despite the fact that part of the income was non-taxable, the depreciation should be allowed in full.

The United States Tax Court held for Allen and his wife on both issues. The Court of Appeals for the Fifth Circuit reversed the Tax Court on the gift issue and hence did not decide the depreciation issue on tax-exempt income.

BASIS FOR JURISDICTION IN THE LOWER COURT

The jurisdiction of the United States Tax Court to hear tax appeals is contained in the following sections of the Internal Revenue Code of 1954 (26 U.S.C.);

Section 7441
Section 7442
Section 6213(a)
Section 6214(a)

ARGUMENT FOR ALLOWANCE OF WRIT

In its decision in this case the United States Court of Appeals for the Fifth Circuit made two errors. First, contrary to the provisions of Rule 52 of the Federal Rules of Civil Procedure, it reversed the United States Tax Court on a question of fact which was not clearly erroneous because it was supported by competent evidence. Second, it misapplied the decision of this Court in *Lyeth v. Hoey*, 305 U.S. 188, to a fact situation entirely different from the one considered in that case.

REVERSAL OF TAX COURT ON QUESTION OF FACT

In its decision entered in this case the United States Court of Appeals for the Fifth Circuit has held that since the gift of the El Paso stock by Rose to Allen and his wife

was being contested by certain beneficiaries under her will, Allen did not have good title to the stock, and hence, when the matter was settled by compromise, this amounted to a determination of the amount of the original gift and hence what Allen and his wife received from the estate they received as donees.

This holding is contrary to the facts as found by the United States Tax Court, which were as follows; (R. 78 to 80).

> "Petitioner possessed on the date of Rose's death certificates representing 70,000 shares of El Paso stock and endorsed stock powers covering the shares naming petitioner and Jeannette as transferees. Under the Uniform Stock Transfer Act, a written assignment by separate document is a valid method of transfer, and an endorsement by the person appearing by the certificate to be the owner is effectual as against all persons except the assignor in spite of fraud, duress, mistake, revocation, death, incapacity or lack of consideration or authority. Moreover, it has been held that possession by the endorsee or his agent of duly endorsed stock certificates establishes prima facie that the transferee has good title to the stock as against the assignor or his representative. * * *
>
> "It is clear that petitioners held the El Paso stock under a bona fide claim of title and possessed the right to transfer it to a purchaser without notice free of all claim by Rose's Estate. * * * At no time did the stock become a part of Rose's probate estate. Certain of the beneficiaries and heirs of Rose threatened action against petitioners to have the stock declared an asset of the Estate. In the arm's length settlement, an interest in the Estate was transferred to petitioners in order to have included in the Estate the property to which peti-

> tioners held a bona fide claim of title. One valuable property was exchanged for another. Petitioners made no claim *against the Estate* as heirs or as donees of lifetime gifts from Rose. * * *
>
> "Undeniably, but for the original 'gift' in the instant case, petitioners would not have been in a position to acquire the life estate. However, in our judgment this simple 'but for' connection does not compel us to attribute gift characteristics to all property thereafter passing through petitioners' hands."

Attention is called to Rule 52 of the Federal Rules of Civil Procedure which reads, in part, as follows;

> "Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses."

The finding of the United States Tax Court that Allen had good title to the El Paso stock was amply supported by Allen's testimony, which was as follows; (R. 30-33)

> "Q. On or about November 11, 1957, did Rose Van Wert deliver to you signed stock powers transferring to you and Mrs. Early certain shares of El Paso Natural Gas Company stock?
>
> "A. Yes she did. * * *
>
> "Q. How many shares were to be transferred?
>
> "A. 70,000. * * *
>
> "Q. Had Rose Van Wert's signature on these stock powers been guaranteed?
>
> "A. Yes, they were. * * *
>
> "Q. Where were the shares of stock at this time?
>
> "A. They were in my possession. * * *

"Q. What did Rose Van Wert tell you was the purpose for giving you the stock powers?

"A. It was a gift.

"Q. What instructions did she give you with respect to the use of the stock powers?

"A. She asked that I do not send them in for transfer until after her death.

"Q. Was this so she could receive the dividends during her lifetime?

"A. Yes sir, it was. * * *

"Q. Did you consider the transfer as a gift?

"A. Yes sir.

"Q. Do you believe that Mrs. Van Wert intended it as a gift?

"A. Yes sir.

"Q. Why do you think so?

"A. That is what she told me.

"Q. What reason did she have for making such a gift to you and your wife?

"A. It was in lieu of changing her will, and as a result of a long or a 10 year friendship between the Van Werts and the Earlys."

Allen's testimony was not refuted and it was believed by the Tax Court. Since the Tax Court's finding, that Allen had acquired good title to the stock by gift from Rose during her lifetime, was amply supported by competent evidence, it should not have been reversed by the Court of Appeals.

THE COURT OF APPEALS HAS WRONGLY APPLIED LYETH V. HOEY

The Court of Appeals has held that in accordance with this Court's decision in *Lyeth v. Hoey*, 305 U.S. 188, since Allen's right to keep the stock acquired from Rose by gift was being contested, whatever he got in compromise of the controversy he received as a donee. This is an unwarranted extension of the doctrine of *Lyeth v. Hoey*.

In *Lyeth v. Hoey* the contestant was an heir of the decedent who had been cut off in the will. As a result of a compromise he received property which he would not have received under the will. The question was whether the property represented income or a bequest. This Court held that since he received the property by reason of his being an heir, the property was a bequest.

Consider how different are the facts in the present case. Allen was not an heir and had no claim against Rose's estate. He held stock given to him by Rose before her death which was no part of her estate. The estate was making a claim against him to get the stock and threatening a suit. To avoid a suit he exchanged his stock for a life interest in the income of the estate. This was an exchange of unlike assets and was not the perfection of his gift, which had already been completed a year before Rose's death.

In this connection the Tax Court said;

> "It is plain that *Lyeth v. Hoey* has no application where the asset, as here, is acquired by purchase or exchange. * * * We believe that to reach the same conclusion as in *Lyeth v. Hoey* under the significantly different facts

presented here would necessitate an unwarranted extension of the rationale of that case beyond the intent of the Supreme Court."

Hence the Court of Appeals has wrongly applied this Court's decision in *Lyeth v. Hoey*, to the facts in the present case.

CONCLUSION

Due to the two errors committed by the United States Court of Appeals for the Fifth Circuit in deciding this case, it is respectfully requested that this Petition to review the case be granted; that the Court reverse the Circuit Court of Appeals; and that it affirm the decision of the United States Tax Court on the issue here presented.

Respectfully submitted

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Dallas, Texas 75206
Attorney for Petitioners.

CERTIFICATE OF SERVICE

It is hereby certified that service of this petition has been made on opposing counsel by mailing three copies thereof on this the ..... day of July, 1971, in an envelope with air mail postage prepaid, properly addressed to him as follows;

Mr. Johnnie M. Walters,
Assistant Attorney General,
Tax Division,
United States Department of Justice,
Washington, D. C. 20530

Leland E. Fiske
Attorney for Petitioners.

APPENDIX

Exhibit A. Opinion of United States Court of Appeals for the Fifth Circuit

Exhibit B. Opinion of the United States Tax Court

EXHIBIT A

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 29240

ALLEN M. EARLY and JEANNETTE B. EARLY,
Petitioners-Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

Appeal from the Decision of the Tax Court of the United States (Texas Case)

(May 21, 1971)

Before COLEMAN, AINSWORTH and GODBOLD, Circuit Judges.

GODBOLD, Circuit Judge: The Commissioner appeals from a decision of the Tax Court which, over the dissents of six of its 15 members, overruled his determination of deficiencies in taxpayers' federal income tax for the years 1964-65, and in addition sustained taxpayers' claims for refunds for the same years. 52 T.C. 560 (1969). At issue is whether, and to what extent, taxpayers are entitled to periodic deductions for amortization of the value of a joint life estate which they acquired from the estate of a decedent.

The basic facts are not in dispute. Taxpayers Allen and Jeannette Early[1] are husband and wife, reside in Dallas, Texas, and filed joint returns for the tax years in question. Both were friends of Sam and Rose Van Wert. For several years prior to 1954, taxpayers acted as Sam Van Wert's accountant. Following Van Wert's death in that year, taxpayer performed the same services for Mrs. Van Wert until her death. At her husband's death Mrs. Van Wert was left with real and intangible personal property of substantial value, including 70,000 shares of stock in El Paso Natural Gas Company. By and large, the certificates and instruments evidencing her ownership of these assets, together with her books and records, were in taxpayer's possession.

In November, 1957 Mrs. Van Wert executed stock powers, covering certificates representing the 70,000 shares of El Paso stock in taxpayer's possession, in favor of taxpayer (50,000 shares) and Mrs. Early (20,000 shares). Mrs. Van Wert's 1957 federal gift tax return, prepared and filed by taxpayer, did not reflect these transactions.

Mrs. Van Wert died August 12, 1958. She left a will and codicil in which she appointed taxpayer and another as co-executors, made various specific and monetary bequests, expressly pretermitted all relatives in "blood or law," and directed that the residue of her estate be placed in trust with the income to be paid to her physician and his wife for their joint lives, the remainder to specified charitable donees. The will and codicil did not specifically mention the 70,000 shares of El Paso stock. Taxpayers claimed ownership of the shares, asserting that in executing the stock powers Mrs. Van Wert had intended to make them a gift[2] of the stock.

Mrs. Van Wert's will and codicil were contested by 44 intestate heirs on the grounds of undue influence and lack of testamentary capacity, and several parties to the controversy objected to taxpayers' retention of the El Paso stock.

[1] Taxpayer, used in the singular, will be used to denote Allen Early.

[2] A bank guaranteed Mrs. Van Wert's signature on the stock powers to be genuine.

A settlement was reached in November, 1959 which in part provided that in return for the surrender of the El Paso stock to the estate, and destruction of the stock powers, taxpayers would be accorded a joint life interest in 32 per cent of the income from the trust reduced by $4000 during each of the first four years. Taxpayers incurred legal fees of $20,000 in connection with this settlement.

The El Paso stock transferred to the estate had a fair market value at the date of transfer of $2,288,125, and it was included in the estate for federal estate tax purposes as a transfer by gift with the retention of a life interest. The value of the El Paso stock comprised about 53 per cent of the corpus delivered to the testamentary trust. The commuted value of taxpayers' joint life estate in the trust income was $716,919.91, based upon an expected joint life of 31.16 years, calculated through the use of the Commissioner's tables.

On January 12, 1960, taxpayer, acting as co-executor of the estate, filed an amendment to Mrs. Van Wert's 1957 federal gift tax return reporting the market value of the El Paso stock at the date of the 1957 transfer for gift tax purposes and paying a gift tax in the amount of $341,898.78. In October, 1961 the estate filed a claim for refund of the gift tax paid pursuant to the amendment of this return. The taxpayer, acting as co-executor of the estate, and the estate tax examiner, negotiated a compromise of this claim under which it was agreed that for tax purposes Mrs. Van Wert would be treated as having made a completed gift to taxpayers in 1957, which would be measured by the actuarial value of the life estate they ultimately received. The gift tax payable was thus reduced to $161,181.29, and the estate received a gift tax refund of $180,717.49. The estate tax return for the Van Wert estate discloses that a credit was allowed against federal estate taxes for the gift taxes actually paid for 1957.

During the years 1961-65 taxpayers reported as income the payments they received from the Van Wert testamentary trust. They also took periodic deductions for amortization

of the cost basis of the life estate. These annual deductions for amortization were calculated by combining the commuted value of the life estate at the time taxpayers acquired it with the $20,000 legal fee incurred in connection with the settlement, *Pennroad Corp.*, 21 T.C. 1087 (1954); *Morgan Jones Estate v. C.I.R.*, 127 F. 2d 231 (5th Cir. 1942), and dividing this by the expected duration of taxpayers' joint life, 31.16 years. However, since the Van Wert trust received part of its income in the form of interest on tax-exempt obligations, taxpayers allocated part of the annual amortization to taxable income and part to income from tax-exempt sources, and did not claim deductions for that part of the amortization allocated to tax-exempt income.

The Commissioner disallowed the deductions for amortization on the ground that taxpayer's life interest was "acquired by gift, bequest, or inheritance" and that the deductions were therefore prohibited by § 273 of the Code.[3] Taxpayers filed a petition for redetermination in the Tax Court, asserting that § 273 was inapplicable. They also contended that notwithstanding the tax-exempt source of some of the income the amortization was fully deductible, and accordingly claimed refunds for the years in which they had not taken deductions for amortization allocated to tax-exempt income. The Tax Court held for taxpayers on both issues, and the Commissioner has appealed. Because we have concluded that § 273 precludes *in toto* the deductions for amortization, we reverse the decision below without reaching the second issue.

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[3] I.R.C. § 273, 26 U.S.C. § 273 provides:

"HOLDERS OF A LIFE OR TERMINABLE INTEREST.

"Amounts paid under the laws of a State, a Territory, the District of Columbia, a possession of the United States, or a foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time."

The section is without helpful legislative history. *See* Gist v. United States, 423 F. 2d 1118, 1120 (9th Cir. 1970).

Central to a resolution of the disputed applicability of § 273 is whether the rationale of *Lyeth v. Hoey*, 305 U.S. 188, 83 L. Ed. 119 (1938), compels the conclusion that for income tax purposes taxpayers acquired their life interest by "gift, bequest, or inheritance." *Lyeth* held that an heir who contested his grandmother's will, and who, as a result of a compromise of that contest, received property from the grandmother's estate which he would not have received had the will gone uncontested, acquired that property "by bequest, devise, or inheritance," and was therefore not liable for federal income taxes. *See* I.R.C. § 102. The Court observed that

> Petitioner was concededly an heir of his grandmother under the Massachusetts statute. It was by virtue of that heirship that he opposed probate of her alleged will which constituted an obstacle to the enforcement of his right * * * .
>
> There is no question that petitioner obtained that portion, upon the value of which he is sought to be taxed, because of his standing as an heir and of his claim in that capacity * * *
>
> Whether he would receive any property [as an heir] depended upon the validity of his ancestor's will and the extent to which it would dispose of his ancestor's estate. When, by compromise and the decree enforcing it, that disposition was limited, what he got from the estate came to him because he was an heir * * * 305 U.S. at 195-97, 83 L. Ed. at 125-26.

The Commissioner contends that taxpayers here acquired their life interest under circumstances analogous to those in *Lyeth*, that since the nature of their claim to the stock was as donees their life interest should also be treated as having been acquired by gift, and that § 273 therefore prohibits amortization.

However, the Tax Court held, and taxpayers contend, that *Lyeth* is inapplicable because taxpayers "sold or exchanged" the stock, to which they had bona fide claims of

title through an alleged prior gift, for their life interest. To characterize the transaction with a different label, it is their contention that they "purchased" their joint life interest, and that § 273 does not apply to "purchased" life estates. *See Gist v. United States*, 296 F. Supp. 526 (S.D. Cal. 1968), *aff'd*, 423 F. 2d 1118 (9th Cir. 1970); *Bell v. Harrison*, 212 F. 2d 253 (7th Cir. 1954).

A taxpayer may legitimately amortize the cost basis of a purchased life interest. But we think that for income tax purposes these taxpayers must be treated as having acquired their life estates by gift and not by sale or exchange, or purchase. It is undisputed that whatever claim they may have had to the El Paso stock was acquired by a purported gift. It was this claim to ownership through an assertedly donative transaction which, among other things, was put in issue by the controversy over the Van Wert estate. The thrust of taxpayers' position in this controversy was that they were donees. We cannot conclude otherwise than that, when the dispute was compromised, whatever taxpayers took they took for income tax purposes as donees.

Taxpayers stress that, while Lyeth asserted his claim against his grandmother's estate, their claim was not against the Van Wert estate but to ownership of the stock through a prior purported gift. It was this conceptualization which underlay the Tax Court's holding that taxpayers "sold or exchanged" the stock for the life estate, and its conclusion that *Lyeth* was therefore inapplicable.

There are circumstances under which the donee of another may through an exchange of rights or property with the donor also acquire a life interest which may be said to be purchased, and which is therefore amortizable notwithstanding § 273. *See Gist v. United States, supra; see also, Bell v. Harrison, supra; William N. Fry, Jr.*, 31 T.C. 522 (1958), aff'd, 283 F. 2d 869 (6th Cir. 1960).[4] And we think that this may be so where that which the donee exchanges consists

[4] The I.R.S. limited its acquiescence in decisions such as *Bell* and *Fry* to transactions that are bona fide and not for tax avoidance purposes. Rev. Rul. 62-132, 1962-2 Cum Bull. 73.

of rights or property previously acquired from the donor.[5] *Cf. Sherman Ewing*, 40 B.T.A. 912 (1939); *C.I.R. v. Matheson*, 82 F. 2d 380 (5th Cir. 1936). It is also true that unlike Lyeth, who had an inchoate claim as an heir against his grandmother's estate, taxpayers here had claims of full ownership to stock which was in their possession, and that, therefore, the settlement involved some exchange of property rights, and in some degree resembled a "sale or exchange" of stock for life estate.

But all compromises, and therefore all transactions within the potential ambit of *Lyeth v. Hoey*, are in some measure exchanges. We believe it is not sufficient to render *Lyeth* inapplicable that taxpayers' status as purported donees took the form of claims to ownership of the stock, which resulted in the settlement resembling a sale of the stock and purchase of the life estate. Whether one relinquishes the right to litigate a suit contesting a will to judgment, as in *Lyeth*, or the claimed right to the possession, use and benefit of stock, as here, we have concluded that so long as the settlement is in substantial measure to resolve an underlying and disputed claim based upon a purported gift, bequest, inheritance or the like, what is received in settlement must be characterized, for tax purposes, by the nature of the underlying and disputed claim resolved.[6] Thus, in circumstances such as those presented by this record, where the rationale of *Lyeth* is implicated but where, in addition,

---

[5] *See* n. 6, *infra*.

[6] We are not prepared to accept the somewhat broader proposition suggested in the Commissioner's brief, that the nature of the transaction by which taxpayers acquired their interest in the stock governs the tax treatment of the life interest. It is the nature of the underlying and disputed claim resolved by the settlement which is crucial, and the nature of the transaction by which taxpayers asserted ownership of the stock is only relevant here because it was the validity of that precise transaction which was in dispute and was resolved by the compromise.

That this broader proposition may have been advanced inadvertently by the Commissioner is indicated by his apparent acceptance of *Ewing, supra*, and *Matheson, supra*, as correct, but distinguishable from the case under consideration because the taxpayers in each of those decisions had a clear and pre-existing right to that which they exchanged.

the transaction resembles a sale or exchange of property, we think that *Lyeth* governs unless it may be said that the circumstances surrounding the transaction fairly exclude the possibility that the exchange is in reality a compromise of an underlying and controverted claim such as one of gift, bequest or inheritance.

Indeed, in the decisions relied upon by the Tax Court majority, and by taxpayers here, there existed no dispute which the exchange may be said to have compromised. Each taxpayer's right to that which he gave up in the exchange was unquestioned. In *Gist v. United States, supra,* a widow in a community property jurisdiction was put to an election by her husband's will. If she took against the will she retained fee simple title to her share in the community and received nothing from her husband. If she elected to take under the will she received a life interest in the income from her husband's share of the community but acceded to her husband's disposition of the remainder interest in her share. In short, she exchanged the remainder interest in her share of the community for a life interest in her husband's share. It was held that the widow acquired the life interest in the income from her husband's share by purchase and that § 273 did not prohibit amortization of the commuted value of that interest.[7] However *Gist*, by reference to such decisions as *C.I.R. v. Siegel*, 250 F. 2d 339, 345-7 (9th Cir. 1957), relied upon the undisputed and vested character of the wife's community interest, which was exchanged for the life interest. 296 F. Supp. at 528. Similarly, *Sherman Ewing, supra,* and *C.I.R. v. Matheson, supra,* which hold that the discharge of a monetary legacy by the transfer of securities constitutes a sale or exchange of the securities, involve legatees whose right to take was not in dispute.

Taxpayers here had no such clearcut right. The Tax Court held that they had a bona fide claim of title to the stock, but refrained from holding that they were undisputed

[7] She was not permitted to amortize that portion of the life interest in the community property which was attributable to her share of the community, for she was entitled to that in any event and in no sense acquired it by either "purchase" or "compromise." 296 F. Supp. at 529.

owners by virtue of the purported gift. Their claim of ownership was very much in dispute, and by the settlement reached taxpayers relinquished any and all claims of fee simple title to the stock. Under the circumstances we conclude that the exchange of stock for life estate was realistically a compromise of taxpayers' disputed right to the stock,[8] and since they claimed the stock as donees they must be treated for federal income tax purposes as having acquired the life estate in that capacity. We need not, and do not, hold that *Lyeth* governs transaction such as this unless the right to that which is exchanged is beyond cavil — the dispute over the purported gift to these taxpayers was more than merely colorable. We hold only that where there exists a substantial controversy in which a taxpayer claims as a donee, what is received in settlement is received for tax purposes as a donee.

Taxpayers urge that *White v. Thomas*, 116 F. 2d 147 (5th Cir. 1940) *cert. denied*, 313 U.S. 581, 85 L. Ed. 1538 (1941), is to the contrary. The taxpayer there claimed ownership of a decedent's ranch through a prior inter vivos gift. In compromise of this claim the estate paid the taxpayer a sum of money. Taxpayer contended that the money received was not includable in gross income for federal tax purposes since it was received in compromise of a claim which he asserted as a donee, and under *Lyeth* should be treated as having been acquired by gift. We held that "[w]hen what is received by a compromise is a part of the very thing claimed, the assertion is correct," but that since taxpayer had not received a part of that claimed, *i.e.*, the ranch, *Lyeth* was inapplicable.

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[8] In reaching this conclusion we do not rely on the absence of any reported gain or loss on the transaction, in view of the Commissioner's concession below that the rights exchanged should be deemed to be of equal value. However, we are not required to accept taxpayer's contention that the exchange was in fact taxable. As far as we are able to ascertain from the record, the Commissioner conceded only that the rights exchanged should be deemed equal in value, so that *if* the exchange was taxable, no gain was *realized*. See 52 T.C. at 565. We consider that the question whether the exchange was taxable is not a consideration in this case.

We think that *White v. Thomas* is inapplicable.[9] When taxpayers surrendered the El Paso stock to the Van Wert estate the estate in turn transferred it to the testamentary trust from which taxpayers were to receive their income interest. As we have pointed out, the value of the stock comprised some 53 percent of the trust corpus. When taxpayers received income from the trust they were in part receiving income from the stock they had relinquished. We think they received a "part of the very thing claimed." The fact that the trustees subsequently sold the stock and reinvested the proceeds in other securities is without relevance. Furthermore, decisions such as *Harte v. United States*, 252 F. 2d 259 (2d Cir. 1958); *James F. Edwards*, 37 T.C. 1107 (1962); and *Darthey Williams*, 36 T.C. 195 (1961) relied upon by taxpayers, involve a construction of the statutory terms "property" and "income from property" under § 22(b) (3) of the 1939 Code[10] and do not affect our conclusion here, which is based upon a more general, nonstatutory determination, of whether taxpayers received a "part of the very thing claimed."

The final string to taxpayers' bow is the assertion that, since a federal gift tax was imposed on the value of their joint life interest for the year 1957, our disposition is prejudicial to them. In taxpayers' words "the Commissioner, having collected a gift tax on the 1957 gift, a refund of which is now barred by limitations, is estopped from denying that the gift took place in 1957." However construed, this contention is without merit. First, it is bottomed on the assumption that a ruling against taxpayers necessarily would be based on the conclusion that they received a gift at the time of the settlement in 1959 and received no gift in 1957. But we accept as a premise that a purported gift was made in 1957, and hold only that, because the validity of the gift was in dispute, the life estate received in the settlement should be treated as though it were acquired by gift. *See Harte v.*

[9] Thus, we need not consider whether the decision has present viability.

[10] § 102 of the 1954 Code.

United States, supra at 261. Moreover, insofar as our holding that for federal income tax purposes the purported 1957 gift was not beyond dispute may carry any implication that the gift was not "complete," this is not necessarily inconsistent with the Commissioner's determination that a gift tax was due for the year 1957. It has long been recognized that the gift tax provisions of the Code are not in pari materia with the income tax provisions, with the result that a transfer sufficiently complete to be subject to a gift tax is not necessarily complete for income tax purposes.[11] Finally, if taxpayers mean to imply that as a result of our holding the estate might be on some theory entitled to a gift tax refund, now barred by the statute of limitations, we note that the gift tax paid for the year 1957 was credited against and reduced the amount of federal tax payable on the Van Wert estate,[12] *see* 26 U.S.C. § 2012, so that any gift tax refund to which the estate conceivably might have been entitled would have been offset by an identical increase in the estate tax payable. We conclude that the payment of a federal gift tax for the year 1957 does not prejudice taxpayers, and in no way affects our ruling with respect to their income tax liability for the year 1962-64.[13]

Since, under the rationale of *Lyeth v. Hoey*, taxpayers must be treated for income tax purposes as having acquired

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[11] *See* Lockard v. C.I.R., 166 F. 2d 409, 411 (1st Cir. 1948.)

> "At the bottom of [taxpayers'] contentions is this implied assumption: The same transaction cannot be a completed gift for one purpose and an incomplete gift for another. Of course, that is not true, as the cases above cited make clear. Perhaps to assuage the feelings and aid the understanding of affected taxpayers, Congress might use different symbols to describe the taxable conduct in the several statutes, calling it a 'gift' in the gift tax law, a 'gaft' in the income tax law, and a 'geft' in the estate tax law." C.I.R. v. Beck's Estate, 129 F. 2d 243, 246 (2d Cir. 1942).

[12] The original estate tax return for the Rose Van Wert estate, together with the federal estate tax examiner's corrections thereto, which a covering letter discloses that taxpayers assented to, are among the original exhibits in this case.

[13] Of course, nothing we have said in any way intimates a view on the validity of the imposition of the 1957 gift tax.

their joint life estate by gift, § 273 of the Code prohibits any deductions for amortization of the cost basis of the life estate. The decision of the Tax Court is therefore

REVERSED.

EXHIBIT B

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52 T. C. 560

Tax Court of the United States

Docket No. 802-67.

ALLEN M. EARLY and JEANETTE B. EARLY,
Petitioners-Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

Filed June 26, 1969.

Petitioners acquired a joint life interest in a percentage of the income from an estate trust in exchange for their transfer to the trust of certain shares of stock transferred to them by decedent outside her probate estate. *Held*, the amortized cost of acquiring the life estate is deductible under sec. 167(a)(2), I.R.C. 1954. *Held further*, that portion of the amortized cost allocable to tax-exempt interest income is not disallowed as a deduction by sec. 265, I.R.C. 1954.

LELAND E. FISKE, for the petitioner.

ROY E. GRAHAM, for the respondent.

DAWSON, *Judge*: Respondent determined deficiencies in petitioners' Federal income tax of $8,533.62 for 1964 and $7,669.87 for 1965. Petitioners have alleged in their petition overpayments of $2,285.16 for 1964 and $3,334.17 for 1965.

The principal question is whether petitioners have an amortizable cost basis in a joint life interest in a percentage of the income from an estate trust acquired in exchange for their transfer to the trust of certain shares of stock transferred to them by decedent outside her probate estate. If we answer the question affirmatively, we must further decide whether the amortized cost is allowable as a deduction to the extent allocable to tax-exempt interest income.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly.

Allen M. Early (herein called petitioner) and Jeannette B. Early (herein called Jeannette) are husband and wife, who resided in Dallas, Texas, at the time they filed their petition herein. Their joint Federal income tax returns for the years 1964 and 1965 were filed with the district director of internal revenue at Dallas, Texas.

Petitioner has been a practicing certified public accountant for many years. In 1949 he was employed by the Creslenn Oil Company as office manager and accountant for its Dallas office. The Creslenn Oil Company operated certain oil properties jointly with Sam N. Van Wert, a friend of the president of the company, and provided him office space and bookkeeping services for a monthly charge. As accountant for the Creslenn Oil Company, petitioner maintained the books and records of Sam N. Van Wert.

In 1954 Sam N. Van Wert died, leaving most of his estate, which consisted of oil properties and a substantial number of stocks and bonds, to his widow, Rose S. Van Wert (herein called Rose). The Creslenn Oil Company, through petitioner, continued to keep the books and records for Rose,

charging her monthly for the service. Her stock certificates, deeds and bonds, as well as her books and records, were in petitioner's possession.

The petitioners and the Van Werts were friends from the time petitioner became employed with the Creslenn Oil Company.

On November 11, 1957, petitioner prepared a number of stock powers covering 70,000 shares of El Paso Natural Gas Company stock (referred to herein collectively as the El Paso stock) owned by Rose, naming petitioner as transferee of 50,000 of the shares and Jeannette as transferee of the remaining 20,000 shares. Rose's signatures on the powers were guaranteed to be authentic by a bank official. The powers contained no reservations. The substance of this transaction was not divulged to others during Rose's life.

In 1958 petitioner prepared and filed a Federal gift tax return for Rose for the taxable year 1957 listing total gifts of $5,818.34, consisting of certain stock and debenture rights, not including the El Paso stock, transferred to petitioner.

Rose died on August 12, 1958, leaving a will with codicil in which four specific bequests were made. Dr. William N. Fuqua, Jr., who was Rose's long-time personal physician, and his wife were given Rose's home and personal effects, a maid was given $75,000, petitioner was given $10,000, and petitioners were given $10,000 in trust for their son. Relatives "in blood or law" of Rose were specifically excluded from any bequest or devise. The residue of her estate was transferred in trust with the income to go to the Fuquas during their lives and the life of the survivor, with the remainder in equal parts to Southwestern Medical Foundation and Salesmanship Club Boys Camp, both charitable organizations.

At the time of Rose's death, petitioner was in possession of the El Paso stock and the stock powers covering it, over which he and Jeannette claimed ownership through an inter

vivos gift from Rose in 1957, which had been subject to a life interest retained by Rose in the income from the stock.

The will and codicil, which were filed for probate in Dallas County, Texas, were contested by some 44 persons claiming to be Rose's heirs, absent a will, upon the grounds that Rose lacked testamentary capacity at the time of their execution or that they were signed by reason of undue influence by some of the beneficiaries. In addition, certain contestants and beneficiaries objected to the retention of the El Paso stock by petitioners and threatened to bring suit to have the stock declared an asset of the estate.

In November 1959 all interested parties executed a settlement agreement under which petitioners agreed to transfer all the El Paso stock to the estate in exchange for 32 percent of the income from the entire estate for the life of petitioner, less $4,000 per year for the first 4 years, and after his death 32 percent of the income to Jeannette, if she survived him, for her life. The stock powers were declared null and void and were destroyed by petitioner. Petitioners paid a legal fee of $20,000 in connection with this settlement.

The El Paso stock surrendered to the Estate of Rose S. Van Wert (sometimes referred to herein as the Estate) by petitioners had a fair market value at the date of transfer of $32.6875 per share, or a total valuation of $2,288,125. Their value was included in the gross estate of Rose in the return filed by her Estate as a transfer by gift with the retention of the income for life. Petitioner was designated by Rose and was appointed as co-executor of her Estate.

On January 12, 1960, the Estate filed an amended gift tax return for Rose for the taxable year 1957 reporting the full value of the El Paso stock as a taxable gift in that year and paying a gift tax of $341,898.78. On October 27, 1961, the Estate filed a claim for refund of the entire amount paid with the amended return. In settlement of the claim, petitioner, as co-executor of the Estate, and the estate tax examiner agreed that for tax purposes Rose made a completed gift to petitioners in 1957, the value of which should

be measured by the actuarial value of the life estate ultimately received by them. As a result of this agreement, a refund of gift tax of $180,717.49 was made to the Estate.

The administration of the Estate was completed on January 31, 1961, at which time all assets were delivered to the trustee of the trust provided for by the will and petitioners began receiving the income according to the settlement agreement. The El Paso stock comprised about 53 percent of the corpus of the trust.

In 1961 petitioner's age was 47 and Jeannette's age was 46. Based upon respondent's actuarial tables, petitioners had a joint expected life of 31.16 years.

In their Federal income tax returns for the years 1961, 1962, 1963, 1964 and 1965, petitioners claimed amortization of a cost basis of the life estates in the Estate of Rose S. Van Wert, computed as follows:

Value of life estate	$716,919.91
Legal fees	20,000.00
Total basis	$736,919.91
Expected life	31.16 years
Annual amortization	$ 23,649.54

The amortization was apportioned between taxable income and nontaxable interest, and the amounts apportioned to nontaxable interest were not claimed as a deduction on their Federal income tax returns. The apportionment was as follows:

Year	*Total Amortization*	*Amortization Deducted in Return*	*Amount Allocated to Nontaxable Interest and Not Claimed as a Deduction*
1961	$23,649.54	$21,968.84	$ 1,680.70
1962	23,649.54	19,904.70	3,744.84
1963	23,649.54	12,622.09	11,027.45
1964	23,649.54	17,748.56	5,900.98
1965	23,649.54	16,515.46	7,134.08

During the years 1961 to 1965, inclusive, the petitioners received taxable and nontaxable income from the Rose S. Van Wert Trust as follows:

Year	*Total Income Received*	*Less Nontaxable Interest*	*Taxable Income Received*
1961	$41,315.32	$ 2,016.17	$39,299.15
1962	29,530.37	4,694.21	24,836.16
1963	31,981.61	14,925.21	17,056.40
1964	62,307.85	15,585.33	46,722.52
1965	53,843.42	16,272.20	37,571.22

Petitioners alleged in their petition that they improperly allocated a portion of the amortized cost to nontaxable income and claim that such cost is deductible in full.

OPINION

Respondent argues that the receipt by petitioners of the life estate pursuant to the settlement with the Estate was tantamount, under the rationale of *Lyeth v. Hoey*, 305 U.S. 188 (1938), to an acquisition by "gift, bequest, or inheritance," precluding amortization of its value by application of section 273, Internal Revenue Code of 1954.[1] In addition, respondent obliquely questions whether Rose intended a gift to petitioners of the El Paso stock. Petitioners view the settlement as a taxable exchange of property which resulted in no gain or loss because the basis of the property transferred by petitioners should be deemed to equal the value of the life estate received, and contend that this value is properly amortizable in full over the life of the asset received without allocation to tax-exempt interest income received from the trust.

[1] All statutory references are to the Internal Revenue Code of 1954 unless otherwise indicated.

SEC. 273. HOLDERS OF LIFE OR TERMINABLE INTEREST.

Amounts paid under the laws of a State, a Territory, the District of Columbia, a possession of the United States, or a foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time.

Petitioner possessed on the date of Rose's death certificates representing 70,000 shares of El Paso stock and endorsed stock powers covering the shares naming petitioner and Jeannette as transferees. Under the Uniform Stock Transfer Act, [2] a written assignment by separate document is a valid method of transfer, and an endorsement by the person appearing by the certificate to be the owner is effectual as against all persons except the assignor in spite of fraud, duress, mistake, revocation, death, incapacity or lack of consideration or authority. Moreover, it has been held that possession by the endorsee or his agent of duly endorsed stock certificates establishes prima facie that the transferee has good title to the stock as against the assignor or his representative. *Scottish Bank v. Atkinson*, 245 N.C. 563, 96 S.E. 2d 837, 839 (1957); *In Re Hill's Estate*, 30 Ill. App. 2d 243, 174 N.E. 2d 233 (1961); *Vincent v. Campbell*, 140 N.J. Eq. 140, 53 A. 2d 313 (1947). See also 1 Christy, Transfer of Stock § 52 (3d ed. 1964).

It is clear that petitioners held the El Paso stock under a bona fide claim of title and possessed the right to transfer it to a purchaser without notice free of all claim by Rose's Estate. *McCullen v. Hereford State Bank*, 214 F. 2d 185 (C.A. 5, 1954). At no time did the stock become part of Rose's probate estate. Certain beneficiaries and heirs of Rose threatened action against petitioners to have the stock declared an asset of the Estate. In the arm's-length settlement, an interest in the Estate was transferred to petitioners in order to have included in the Estate the property to which petitioners held a bona fide claim of title. One valuable property right was exchanged for another. Petitioners made no claim *against the Estate* as heirs or as donees of lifetime gifts from Rose (except as to the $20,000 in specific bequests). Cf. *White v. Thomas*, 116 F. 2d 147 (C.A. 5, 1940), certiorari denied 313 U.S. 581 (1941).

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[2] Vernon's Texas Ann. Civ. St., Art. 1302-6.01 et seq. (1962), which was derived from Acts 1943, 48th Leg., p. 722, ch. 397, § 26. These provisions have the effect of making shares of corporate stock fully negotiable. *Snyder Motor Co. v. Universal Credit Co.*, 199 S.W. 2d 792 (Tex Civ. App. 1947).

In *Lyeth v. Hoey, supra*, the Supreme Court held that property acquired by an heir under State intestacy laws in compromise of his claim, based upon an alleged invalidity of a will under which he was granted a small legacy, *against the estate* for a greater portion of *that very property* constituted "property acquired by gift, bequest, devise, or inheritance." Undeniably, but for the original "gift" in the instant case, petitioners would not have been in a position to acquire the life estate. However, in our judgment this simple "but for" connection does not compel us to attribute gift characteristics to all property thereafter passing through petitioners' hands. It is plain that *Lyeth v. Hoey* has no application where the asset, as here, is acquired by purchase or exchange. Cf. *White v. Thomas, supra; Bell v. Harrison*, 212 F. 2d 243 (C.A. 7, 1954); and *William N. Fry, Jr.*, 31 T.C. 522 (1958), affd. 283 F. 2d 869 (C.A. 6, 1960). We believe that to reach the same conclusion as in *Lyeth v. Hoey* under the significantly different facts presented here would necessitate an unwarranted extension of the rationale of that case beyond the intent of the Supreme Court.

In *White v. Thomas, supra*, the rationale of *Lyeth v. Hoey* was not applied to a settlement in which a claim, based upon a purported inter vivos gift, against specific estate property was compromised by the transfer of estate property dissimilar in nature to that claimed. As a result, the amounts received under the settlement were held not to be "the proceeds of a gift," but income. In the instant case, technically as well as practically, the life estate in the trust comprised of various assets managed by fiduciaries was not "a part of the very thing claimed," i.e., a remainder interest in shares of stock.

In our opinion petitioners acquired their joint percentage life estates through the sale or exchange of property, and not by gift, bequest or inheritance. *Sherman Ewing*, 40 B.T.A. 912 (1939); *Commissioner v. Matheson*, 82 F. 2d 380 (C.A. 5, 1936), affirming 31 B.T.A. 493 (1934); *White v. Thomas, supra; Gist v. United States*, 22 A.F.T.R. 2d 5895

(D.C. S.D. Calif. 1968). Accordingly, section 273 is inapplicable.

Respondent did not determine in the notice of deficiency, plead in the answer, or make any argument in the brief that the transaction, if characterized as a "sale or exchange," resulted in a gain to petitioners and, in effect, concedes that the properties exchanged should be deemed to be of equal value resulting in a "cost" to them, for purposes of amortization, of the actuarial value, as of the date of transfer, of the life estate received.[3] Petitioners properly added the $20,000 legal fee incurred by them in the settlement proceedings to this value in determining "cost." *Pennroad Corporation*, 21 T.C. 1087 (1954); *Morgan Jones Estate v. Commissioner*, 127 F. 2d 231 (C.A. 5, 1942). Thus, no issues as to gain or basis are raised herein.

It is well established that the cost of purchasing a life estate measured by the life of the grantor is amortizable over his life expectancy. *May T. Hrobon*, 41 T.C. 476, 503 (1964); *Bell v. Harrison, supra; William N. Fry, Jr., supra; Elmer J. Keitel*, 15 B.T.A. 903 (1929). The concept of recoupment of investment is equally operable in a case such as this where the purchased life interest is measured by the grantee's own life. We so hold.

Since petitioner's life estate constitutes property held for the production of income, its amortized cost is deductible under section 167(a)(2) [4] unless disallowed in whole or in part by section 265. [5]

[3] By way of settlement under the Federal gift tax provisions, respondent determined that Rose made a gift to petitioners in 1957, the value of which should be measured by the actuarial value of the life estate ultimately received by them.

[4] SEC. 167. DEPRECIATION.
(a) General Rule. — There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) — * * *
(2) of property held for the production of income.

[5] SEC. 265. EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME.
No deduction shall be allowed for —
(1) Expenses. — Any amount otherwise allowable as a deduction which is allocable to one or more classes of income

A portion of the trust income paid to petitioners during the years 1964 and 1965 constituted taxable income and the remainder constituted tax-exempt interest income. Under the plain, unambiguous provisions of section 265, expenses allocable to tax-exempt *interest* income are disallowed only to the extent of amounts otherwise deductible *under section 212*. See Rev. Rul. 61-86, 1961-1 C.B. 41.

It is not disputed that the amortized cost is deductible, if at all, under section 167(a)(2). See *KIRO, Inc.*, 51 T.C. 155 (1968). Undeniably, the provisions of section 167(a)(2) are parallel to those of section 212,[6] and a logical case may be made that section 265 should have included a reference to section 167(a)(2). "However, our present problem is to interpret the Act passed, not to determine what type of an Act could have been passed." *Gillman v. United States*, 235 F. 2d 87, 93 (C.A. 8, 1956). "It is not our responsibility to rewrite the statute. We must interpret it as we find it." *Mary E. Burrow Trust*, 39 T.C. 1080, 1091 (1963), affd. 333 F. 2d 66 (C.A. 10, 1964).

We are not called upon to interpret a necessarily ambiguous phrase such as "capital assets," *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955), or an imprecise economic concept such as "loss," *Helvering v. Owens*, 305 U.S. 468 (1939), which may be interpreted broadly or narrowly according to the basic congressional purpose.

other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this subtitle, or any amount otherwise allowable under section 212 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this subtitle.

[6] SEC 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year —

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

Therefore, we find no occasion to resort to speculation as to legislative intent.

We conclude that petitioners are entitled to a depreciation deduction during the years in issue under section 167(a)(2), unaffected by section 265, for the full amortized cost of their life interests in the Estate trust.

Reviewed by the Court.

Decision will be entered under Rule 50.

In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-127

ALLEN M. EARLY AND JEANNETTE B. EARLY,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. App. B1–B11) is reported at 52 T.C. 560. The opinion of the court of appeals (Pet. App. A1–A12) is not yet reported.

JURISDICTION

The court of appeals entered an opinion and judgment on May 21, 1971 (Pet. App. A1–A12). A petition for rehearing was denied on June 16, 1971. The petition for a writ of certiorari was filed on July 26, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

442-497—71

QUESTION PRESENTED

A dispute over petitioners' ownership of certain stock, claimed by petitioners to have been acquired by gift, was settled by relinquishment of the stock in exchange for a joint life interest in the income of a trust. The question presented is whether amortization of the alleged cost basis of the acquired interest is precluded by Section 273 of the Internal Revenue Code of 1954, which prohibits amortization of a life or terminable interest acquired by gift.

STATUTES INVOLVED

The pertinent statutes are set forth in the petition (pp. 2–4).

STATEMENT

Petitioner,[1] a certified accountant, maintained the books and records of Sam N. Van Vert for a number of years. Petitioners and the Van Verts became friends, and when Mr. Van Vert died in 1954, petitioner continued to maintain his widow's books and records. Petitioner also kept in his possession the widow's stock certificates, deeds and bonds. (Pet. App. B2–B3.)

On November 11, 1957, petitioner prepared a number of stock powers covering 70,000 shares of El Paso Natural Gas Company stock owned by the widow, naming himself as transferee of 50,000 shares and his wife as transferee of the remaining 20,000. The widow's signatures on the powers were guaranteed authentic by a bank official. The powers contained

[1] References to petitioner are to Allen M. Early. References to petitioners are to Mr. Early and his wife Jeannette.

no reservations. The substance of this transaction was not divulged to others during the widow's life. (Pet. App. B3.)

The widow died on August 12, 1958, leaving a will and codicil which provided, *inter alia,* for $20,000 to petitioners. All relatives were specifically excluded as beneficiaries, and most of the residue of the estate was transferred to the widow's physician for life, remainder to charity. At the time of the widow's death, petitioner was in possession of the El Paso stock and the stock powers, and he and his wife claimed ownership of the stock through a 1957 *inter vivos* gift from the widow, subject to the widow's retained life interest. (Pet. App. B3–B4.)

The will and codicil were contested by 44 of the widow's claimed heirs on the grounds of her lack of testamentary capacity, and undue influence on the part of some of the beneficiaries. In addition, certain contestants and beneficiaries objected to petitioners' retention of the El Paso stock and threatened to bring suit to have it declared an asset of the estate. In November, 1959, all interested parties executed a settlement agreement under which petitioners agreed to transfer all of the El Paso stock to the estate in exchange for 32 percent of the income from the entire estate for their joint lives.[2] The stock powers were declared null and void and were destroyed. (Pet. App. B4.)

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[2] The amount received by petitioners was to be reduced by $4,000 in each of the first four years (Pet. App. B4).

In their federal income tax returns for 1961–1965, petitioners claimed that they were entitled to amortize the value of their life interest in the widow's estate over their joint expected lives. The Commissioner disallowed the amortization deductions on the grounds that the life estate was obtained in compromise of petitioners' claim to ownership of the stock by gifts; that under *Lyeth* v. *Hoey*, 305 U.S. 188, the life interest itself must be deemed acquired by gift; and that Section 273 of the Internal Revenue Code specifically prohibits the amortization of life interests acquired by gift. The Tax Court allowed the deductions, reasoning that, unlike the situation in *Lyeth*, petitioners here already held the stock under a "bona fide claim of title," so that the subsequent exchange of the claim of title for the life interest did not constitute a gift (Pet. App. B7–B8). The court of appeals reversed, upholding the Commissioner's position (Pet. App. A5–A12).

ARGUMENT

The decision below is correct. There is no conflict of decisions or other reason for review by this Court.

Section 273 of the 1954 Code prohibits amortization of a life or terminable interest acquired by "gift," "bequest" or "inheritance." In the instant case, the court of appeals properly rejected petitioners' claim that their interest was acquired by purchase, holding that (Pet. App. A6–A12) petitioners' life interest was acquired by gift, since it was obtained as a result of a settlement with respect to disputed claims to the El Paso stock which they allegedly received by gift.

Petitioners' contention (Pet. 8–11) that this holding ignores the Tax Court's finding that they had "good title" to the stock before the compromise is incorrect. The Tax Court termed petitioners' interest in the stock prior to the compromise as "claimed ownership" (Pet. App. B3) or a "bona fide claim of title" to the stock (Pet. App. B7), not "good title" or outright ownership.

Petitioners' relinquishment to the alleged donor's estate, under threat of litigation, of their "bona fide claim of title" to the stock, allegedly received by gift, in return for a 32 percent life interest in the entire estate, brings this case squarely within the rationale of *Lyeth* v. *Hoey*, 305 U.S. 188. *Lyeth* holds that the subject matter of a compromised claim carries over to characterize a settlement payment for tax purposes. It is not inapplicable, as petitioners assert, on the ground that what the taxpayer there received was obtained because of his threat to bring suit as an heir against the estate, while here petitioners already had possession of the property under a "bona fide claim of title." As the court of appeals held (Pet. App. A7), "so long as the settlement is in substantial measure to resolve an underlying and disputed claim based upon a purported gift, bequest, inheritance or the like, what is received in settlement must be characterized, for tax purposes, by the nature of the underlying and disputed claim resolved."

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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